

CENTRAL INTELLIGENCE AGENCY
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MEMORANDUM

SOVIET POLITICS AND SLOWER INVESTMENT GROWTH

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Summary

In 1975 the Soviet Politburo slashed the growth rate of investment by half, a step that probably further retarded economic growth. Slow economic growth in the early 1970s necessitated a sharp cut in the growth rate either of investment, or of consumption, or of military spending. Forced to choose, the leadership in effect risked damaging the country's economic future in order to maintain a high growth rate of military spending and consumption in the short run. This politically grounded decision was particularly detrimental to the interests of civilian heavy industry, and raises questions about the political clout of officials responsible for this sector. More fundamentally, the decision testifies to the current leadership's extremely strong commitment to increasing Soviet military power. All indications are that the 1981-85 five-year plan will continue the policy of slowing investment.

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Introduction

One of the central issues in Soviet deliberation over the new five-year plan (1981-85) is the relation of investment to the growth of national income, and in particular how large a share of national income should be allocated to civilian investment. Although resolution of this issue requires elaborate economic calculations, it is basically a political

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decision. Earlier, as the result of a fundamental political decision in 1975, the share of national income allocated to investment was reduced. As a result, perhaps for the first time in the postwar period, the increment in investment in the current five-year plan (1976-80), is actually less than it was in the preceding five-year plan. []

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A key question now is whether the recent downturn in the growth of investment will be reversed in the next five-year plan. Although the basic guidelines for the new plan have not yet been published, the writings of Soviet political leaders and academic figures indicate that the share of planned national income allocated to investment will not increase. This implies that investment would grow at its current historically low rate, or might even be further reduced. If the new five-year plan, when published, bears this out, it would suggest that the Soviet leadership is reconciled to a further decline in economic growth, at least for the next five years. In time, defense spending will be affected by the slowed growth of the economy, but for now civilian investment apparently is not to be favored at the expense of defense. []

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The following presentation is in two parts. The first is a short discussion of recent signs that investment growth is to remain low during the next five-year plan period despite evident opposition to this policy. The second is an extended discussion of the key political decision taken in 1975 that initiated the sharp downturn in investment growth and signalled the implicit acceptance by the Soviet leadership of a prolonged period of reduced growth of national income. []

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I. Investment in the Next Five-Year Plan

The productivity of Soviet investment capital is low, so that investment historically has grown more rapidly than national income and has received an increasing share of national income. A long-standing effort to increase the efficiency of capital has not been successful. The decision in 1975 to reduce the growth rate of investment, therefore, cannot be explained as simply the result of a reduced need for capital. On the contrary, large infusions of capital are still required, and the failure to supply it in sufficient amounts is hurting the Soviet economy. []

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The slowdown in capital formation could not be occurring at a worse time. Greater investment is needed to counter the declining increments to labor, to modernize obsolete plant and equipment, and to stave off the impending energy crunch. The required investment programs are becoming much more costly, however, and

their payoff further away as more investment resources must be devoted to Siberia.* [redacted]

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Despite the urgent need for increased capital investment, Soviet discussions of future economic policy uniformly assert that the share of national income allocated to consumption will not be reduced, which implies that income allocated to "accumulation" (investment) will not increase. Premier Aleksey Kosygin, after noting the long-standing practice of increasing investment more rapidly than national income, claimed in mid-1979 that this had been reversed in the first three years of the current plan. He called this "a positive tendency" that "must be incorporated in plans for the future."** If this were done, the share of national income allocated to investment would not increase. If the growth rate of national income itself continued to decline, as is highly likely, the result would be a further reduction in the growth rate of investment compared to the current five-year plan. Kosygin's insistence that future economic plans should not increase the share of national income allocated to investment presumably reflects decisions that already have been adopted, inasmuch as the principle has been presented in recent months by several writers as authoritative.*** [redacted]

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* "Capital costs have been rising rapidly, particularly in the extractive industries, as a result of the declining quality and quantity of easily accessible raw materials and, in turn, from the increased reliance on more sophisticated and expensive recovery techniques. The need to transport these commodities over much greater distances...also has pushed up capital expenditures. Major gains in energy efficiency may require upgrading industrial technology--a very time-consuming, capital-intensive process...." [redacted]

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** A. N. Kosygin, "Course Toward Effectiveness: The Most Important Link in the Party's Economic Policy," Planovoye Khozyaystvo, No. 7, 1979, pp. 3-17. Kosygin had previously stressed the need to reduce the share of accumulation in national income in his speech on the five-year plan to the Twenty-Fifth Congress. [redacted]

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*** Ye. Ivanov and A. Eskina, "The Intensification of the Investment Process," Planovoye Khozyaystvo, No. 5, 1979, pp. 5-9; A. G. Aganbegyan, "New State in the Evolution of the System of Economic Management," Eko, No. 10, October 1979, pp. 6-7; and A. G. Granberg, "Siberia in the National Economic Complex," Eko, No. 4, April 1980, p. 101. [redacted]

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The opposition to this principle by advocates of a continued concentration on economic growth was strikingly revealed in the party's major theoretical and political journal, Kommunist, by Vadim Medvedev, head of the Central Committee's Academy of Social Sciences. According to Medvedev, development of the productive process could not be directly subordinated to satisfaction of the needs of the working people until the USSR achieved "mature socialism."* This goal was "moved into first place" initially in the ninth five-year plan (1971-75) and subsequently in the current five-year plan. []

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Having established that growth has been subordinated to other needs of the economy, Medvedev finds it necessary to refute contradictory views:

Occasionally one encounters arguments evidently cast up by one or another difficulty or unresolved problem, such as: is it not necessary first to complete the industrialization of agriculture and fully eliminate its lagging, develop still further machine building and other heavy industry sectors, and only then undertake the basic solution of problems related to upgrading the people's prosperity?** []

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Medvedev's rejoinder to the questions he raises is sharp:

The answer to this question is given in party documents....Modern socialist production cannot be developed successfully over a long period of time without subordinating it to the satisfaction of the needs of the people. []

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In defending consumption against the competing requirements of production--presumably demands for more capital--Medvedev oddly finds it necessary to deny that the

* Previously, according to Medvedev, insuring the full prosperity of all members of society had to be subordinated to the resolution of more urgent historical problems, such as "overcoming the long-standing economic backwardness of the country, strengthening its defense capability, technical modernization, restoration of the economy destroyed by the war, and so on." []

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** This may be an allusion to such leaders as Andrey Kirilenko, who has special responsibility for machine building and is a persistent advocate of its needs. []

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economy is in crisis.* Although he attributes this allegation to bourgeois propaganda, one is intrigued by the possibility that partisans of increased investment, as well as partisans of basic organizational reform, might also be charging that the Soviet economy is headed for a crisis. Soviet perception of the steady decline in the growth rate of national income is unquestioned and, at least by economists, is emphasized. []

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CAPITAL INVESTMENT IN THE SOVIET ECONOMY¹

<u>Year</u>	<u>Total</u> (in millions of rubles)
1955	22,546
1956	25,945
1957	29,230
1958	33,989
1959	38,521
1960	41,394
1961	43,239
1962	45,314
1963	47,620
1964	51,887
1965	56,015
1966	59,933
1967	64,927
1968	70,048
1969	72,369
1970	80,671
1971	86,499
1972	92,672
1973	97,021
1974	103,923
1975	112,895
1976	117,970
1977	122,287
1978	129,685
1979	130,900
1980 (planned)	135,300

¹ The basic source for this table is the annual issues of Narodnoe Khozyaystvo SSSR. []

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* He states: "We decisively reject as groundless and as having nothing in common with reality the fabrications of bourgeois propaganda about some kind of crisis in the socialist economy, and its hypocritical advice on how to 'improve' and 'liberalize' socialism. This conceals the profound wish on the part of our opponents to weaken its foundations."

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Although Medvedev appears to favor the priority of consumption over production, he leaves aside the question of what priority should be given defense. This is puzzling, although it is doubtful that Medvedev, or the party documents to which he refers, mean to deprive defense of its top priority. After all, the crucial 1975 decision to reduce sharply the growth rate of civilian investment was followed by a decline in the growth of consumption in the tenth five-year plan, while defense spending continued to grow at its former rapid rate. []

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II. The 1975 Decision to Slow the Growth of Investment

One of the most striking developments in Soviet politics during the Brezhnev era was the 1975 decision to halve the planned growth rate of investment in the tenth five-year plan. The decision was remarkable for several reasons. It departs from the bureaucratic practice of incrementalism, and in particular goes counter to the State Planning Committee's (Gosplan) penchant for straight-line extrapolation of production targets and key plan indicators. True, the continued slowing of the economy required major adjustments in the allocation of resources. A typical bureaucratic solution to this problem, however, might have provided for allocating the projected increase in national income to consumption, defense, and investment in roughly the same proportions as in the past. That this was not done, that the main brunt of reduced allocations for the 1976-80 plan period was borne by the investment sector, poses a political, as well as an economic, problem that warrants more analysis than it has yet received. []

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The need to improve the effectiveness of the factors of production--labor and capital--had long been recognized and had been heavily stressed since the late 1960s. Improved effectiveness was explained as necessary because of the maturation of the Soviet economy and the reduced growth rate of the labor force owing to demographic causes. The rising capital-output ratio was often deplored, and measures to make capital more productive were emphasized. []

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Assuming that the program to increase the effectiveness of production was to succeed, the resulting savings could be used for two distinct purposes: to increase the growth rate of national income, which had been unevenly but persistently slowing since the late 1950s; or to reduce the growth rate of investment and enable investment funds to be diverted to other purposes. (The savings could also be employed, of course, in combination for both purposes.) []

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The idea that the planned increase in effectiveness might be used chiefly to reduce the share of national income allocated to investment (while maintaining the current growth rate of the national economy) had occasionally been voiced by economists in the early 1970s, but apparently was not broached by a top-level political leader until Brezhnev's

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key address to the Party Central Committee on the state of the economy in December 1974. The Soviet leader stated: "The greater the effectiveness (of production) the better will we be able to combine high growth rates of the national economy with an increase in the share of the national income allocated to satisfaction of social requirements." Since national income, in Soviet usage, has two parts, consumption (here referred to as "social requirements") and accumulation (chiefly investment), an increased share allocated to consumption would imply a reduced share for investment. Brezhnev's statement was tentative and conditional, however, suggesting that a final decision had not been taken. []

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Like most speeches to the Central Committee in the post-Khrushchev period, the address was not published at the time of its delivery. It first appeared in a collection of Brezhnev's economic speeches that was approved for publication on 9 July 1975. Not long afterwards a review of this collection by V. N. Kirichenko, published in the government newspaper, Izvestiya on 21 August 1975, implied that a decision had in fact been taken to reduce the share of utilized national income allocated to investment in the tenth five-year plan, as well as the growth rate of investment, based on a postulated increase in the effectiveness of production.* []

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The author downgraded investment growth as a means of increasing production:

Today the chief source of an increase in production is not so much a further increase in the amounts of capital investments . . . as it is the ever fuller utilization of accumulated production capacities The decisive area of technical and economic policy is the intensification of production and a long-range changeover to a qualitatively new type of production, which is characterized by a relative saving . . . of embodied labor (reductions in the rate of assets consumption and materials intensiveness of production) and by a substantial increase not only in the amount but also in the share of the resources used by society to (1) achieve an upswing in the people's well-being and (2) accomplish a wide range of social tasks.**

* *Izvestiya*, 21 August 1975. The author, V. N. Kirichenko, shortly afterward became the Institute's Acting Director and in February 1977, Director of Gosplan's Scientific Research Economic Institute. []

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** This may be a reference to defense needs. []

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The theses on the intensification of production and the qualitative factors of economic growth that are formulated in L. I. Brezhnev's speeches and reports are of very great importance in the formation of the plans for the development of the national economy in 1976-1980 and for the long-range future. [redacted]

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That an increased share of national income was to be allocated to consumption, hence a reduced share to investment, was asserted almost simultaneously by V. N. Kirichenko's superior in an article in the party journal Kommunist in August 1975.* This supports the inference that an authoritative decision to reduce the share of investment in the national income was revealed to the interested Soviet public in August 1975. The fact that both articles were written by high officials of Gosplan's Scientific Research Economic Institute suggests that economic research in support of this decision may have been centered at this institute. [redacted]

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A global decision on the allocation of the national income was needed at about this time so that Gosplan could make the detailed allocation of the available investment funds to ministries, associations, and enterprises according to the production targets assigned them. Indeed, when the draft "Directions of the National Economy" was published several months later the growth rate of investment had been reduced by roughly one half, from 7 percent in the previous five-year plan to around 3.5 percent in the tenth. Subsequently, when presenting the five-year plan to the 25th Party Congress, Kosygin emphasized that it provided for an increased share of national income allocated to consumption, consequently a reduced share for accumulation, hence investment. [redacted]

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Granted that the Politburo decided in mid-1975 to adapt to the slowing growth rate of the economy by sharply reducing the growth rate of investment in the tenth five-year plan, what did this decision imply as to allocations of national income to consumption, investment in the civilian economy, and defense? "Consumption" presumably rose as a share of "utilized national income" because of the sharp reduction in

* Kommunist, No. 11, August 1975. The substance of this article by Yefimov, it should be noted, was not put in question by Kommunist's editors by adding the frequently employed notation that a particular article is being published for "purposes of discussion." [redacted]

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"accumulation."* What of defense? CIA's Office of Strategic Research, basing itself on detailed analysis of the cost of Soviet weapons procurement, has concluded that Soviet defense spending continued to grow in the tenth five-year plan at about the same annual rate as before--that is, 4 to 5 percent. []

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Although the reduction in extensive growth (that is growth by increasing the quantity of the factors of production) was largely a natural phenomenon in the case of the labor force, hence unavoidable, this was not equally true of capital. The reduced growth rate of capital resulted from *deliberate choice*. The leadership had the option to maintain, or even to speed up, the growth of capital while trying to increase its effectiveness, thereby enhancing the growth of the national income; this, however, was not the path chosen. Instead, the Politburo decided to slow the growth of investment, relying on increased effectiveness of capital to compensate for the reduced availability of capital []

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How did the Politburo come to make this decision? The decision almost certainly had both political and economic dimensions. Politically, the decision to cut the growth rate of investment sharply may perhaps best be understood as the necessary consequence of prior decisions not to cut sharply the growth of defense or consumption. The decision not to slow the growth of consumption may have been thought expedient because of concern that frustrating the consumer's high expectations would adversely affect labor productivity, as well, perhaps, as the political mood of the people. []

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Why, however, was the Politburo unwilling to slow the growth of military spending at a time when circumstances were highly conducive to such a decision? The choice actually made--to continue the rapid growth of defense spending--came after the onset of detente, after SALT I and the Vladivostok agreement had recognized Soviet strategic parity with the United States, after substantial Soviet

theater buildups in Europe and the Far East had improved the military balance, and after a decade of rapid increases in Soviet defense expenditures and several years of declining US spending, in real terms, for defense. The decision was roughly coincident with the Helsinki agreement that virtually ratified Soviet World War II gains in Eastern Europe. Then, if ever, was a time when economic constraints might safely have been given their due weight against the claims of defense. Yet an opposite choice was made, to maintain the growth rate of defense spending while sharply cutting the growth rate of investment. In effect, investment funds were diverted to defense. []

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* *Civilian consumption and Group B industry, which chiefly services it, did not fare especially well in the tenth five-year plan, but the planned growth rate of real personal income, as independently measured by CIA, was not reduced sharply.* []

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The decision to put the main burden of the slowed growth of the economy on investment also had an economic dimension. Economists engaged in research as consultants to the government and the party had occasionally argued that excessive growth of the capital-labor ratio contributed to the reduced effectiveness of capital. It followed that a reduction in the growth of investment might be a positive good, enabling improvements to be made in the structure of the economy and the utilization of capital. []

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Whatever the merits of this argument, it apparently did not command a consensus, or even wide support, in the economic profession. Assuredly, it is not the kind of argument that would ordinarily appeal to political leaders who for over a decade had fought the slowing growth of the national income by regularly increasing the share of it allocated to investment.* Apparently none of the political leaders have subscribed to the view that reduced growth of investment might be conducive to enhanced growth of the national income. On the contrary, Brezhnev strongly lamented the shortage of capital in the tenth five-year plan. After telling the Central Committee on 25 October 1976 that the new plan allocated the huge sum of 170 billion rubles to agriculture, Brezhnev said, "I tell you frankly, it was not easy to find it. We had to axe (urezat') the requirements of other branches of the economy." []

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Viewing matters in this fashion, Brezhnev seems unlikely to have expected the reduced growth of investment to be good for the economy. Certainly, there appear to be good grounds for concern that insufficient capital in the tenth five-year plan might hamper capital intensive projects in energy, raw materials, extraction, transportation, agriculture, ecology, and regional development, particularly in Siberia, that are required to sustain economic growth.** These concerns are still prevalent. A Gosplan official recently admitted to a US Embassy officer that investment constraints might hamper economic growth and heighten intersectoral and interregional conflict over resources. []

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By its very nature, a decision to apportion the projected growth of national income to the various claimants is political in nature, and would not be allowed by the Politburo to go by default to technocrats. The economic argument for slowing investment, however, may have given intellectual support to the Politburo's politically grounded decisions. Because "economic science" provided arguments for reduced growth of

* It should be noted, however, that in a somewhat analogous situation in the late 1950s, when the growth of the labor force was similarly slowing, an even higher rate of growth of investment, well over 10 percent, was cur sharply. []

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** The tenth five-year plan allocated sharply increased and substantial investment funds to ecological programs. []

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investment, it became easier to depart from the long-standing practice of planning investment growth to exceed the growth of national income. Whatever the weight given this economic argument in Politburo deliberations, it clearly was relevant to the Politburo's decision. This may help to explain why the key political decision on global indicators in the tenth five-year plan were revealed in articles by establishment economists several months before the plan directives were unveiled to the Supreme Soviet. []

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Judging by available public evidence, the thesis that slowing the growth of investment might increase the effectiveness of capital was not widely debated, either in the economics profession or among economic administrators. The deliberations that led to the decision to cut investment growth in the tenth five-year plan appear to have been conducted within a rather narrow circle of Politburo leaders, aided by Central Committee officials, economic consultants, and planning officials. Brezhnev on several occasions has emphasized the Politburo's increasing involvement in the drafting of the plan. A formal decision on the plan's global indicators probably was adopted by the Politburo, perhaps at the instigation of Brezhnev, who was the first to broach it in public. []

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The management apparatus that was so powerfully affected by the decision does not appear to have been deeply engaged in the discussions that led to it. Certainly economic administrators did not have a decisive voice in the outcome. This puts in question the conventional wisdom that there is a powerful interest group centered in heavy industry, which observers frequently conjoin with interest groups in defense industry and the army and refer to as the "military-industrial complex." Although the political potency of the army and of the defense industry is evident, there are serious grounds for doubt that officials responsible for heavy industrial production in the civilian economy constitute an interest group of comparable weight. According to Brezhnev and other top leaders, the leaders of industry (including heavy industry) have powerful appetites for investment capital. They may have resisted the decision to reduce the growth rate of total investment, for they were not compensated by receiving an increased share of that investment. In fact, they were given no more favorable treatment than agriculture, which is generally thought to be represented in Soviet politics by a weak interest group.* []

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Even if it is agreed that officials responsible for civilian heavy industry may not be as avaricious for capital goods as Brezhnev has alleged, they still had strong grounds

* Agriculture's favorable treatment in the tenth five-year plan may be due to Brezhnev's personal commitment to current programs, and might be jeopardized when Brezhnev leaves the scene. []

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for dissatisfaction with the tenth five-year plan, since the growth rate of their production targets was reduced considerably less than the growth rate of the investment capital allotted them. In the ninth five-year plan (1971-75) national income actually rose 28 percent, assisted by a 41.3 percent increase in total new investment; in the tenth five-year plan national income was targeted to rise a comparable amount, 24-28 percent, assisted by only a 24-26 percent rise in new investment. Although the entire economy was being pressured to increase production without benefit of the full complement of capital investment that had been provided in the past, civilian heavy industry was particularly disadvantaged in the tenth five-year plan, since it was deprived of the preferential treatment previously accorded it.

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Economic managers in heavy industry were required by the tenth fiveyear plan to produce more with less--something Soviet economic administrators, as a breed, are known to resist. That they subsequently failed, as a group, to meet this requirement in the course of the tenth five-year plan reinforces the argument that they probably offered strong resistance to the demand when first confronted with it. It is difficult to avoid the conclusion that the civilian ministries engaged in heavy industrial production are not as powerful an interest group as many political scientists have supposed, or if they once were, are so no longer. Their political clout is being newly tested in the current politicking over the eleventh five-year plan, and right now their prospects, as noted in the first part of this paper, do not look good.

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